OPENING STATEMENT OF
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SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON PROTECTING POLICYHOLDERS FROM TERRORISM

WEDNESDAY, OCTOBER 24, 2001

Mr. Chairman, I must commend you for your perseverance and determination in convening this important hearing to examine the impending availability crisis for terrorism reinsurance and to discuss potential alternatives for resolving this liquidity problem.

Prior to the assaults on the World Trade Center and the Pentagon, most Americans took their security for granted. The shock of the suicide attacks, however, has altered how we each assess risk. This adjustment has become especially apparent in the insurance industry. Prior to September 11, many insurance companies could not price for terrorism risk and offered it for free. Although such practices demonstrated poor economic judgment, many insurers have fortunately indicated that they have sufficient resources to absorb the catastrophic losses of the attacks.

Given the magnitude of the destruction in New York City, we should expect sharp hikes in business insurance premiums. But concerns have also arisen that any future terrorist incident of a similar or greater size could threaten the stability of the property and casualty industry. Further, many reinsurers have decided to curtail their coverage for future terrorism events because they cannot presently determine how to price the frequency, severity, or location of these acts. This problem appears especially acute in high-density areas with large-scale commercial activity.

Any scarcity in terrorism reinsurance will have deleterious effects on our already sluggish economy. Although this contraction in our reinsurance markets has not yet fully manifested itself, it soon will. According to the American Insurance Association, more than 70 percent of businesses renew their insurance contracts at the end of each year. This means that companies of all kinds could find themselves without protection against terrorism on the first day of 2002.

At that time, firms unable to obtain full insurance coverage might choose to cease some or all of their activities because of a determination that the risks from continuing business is too great. This outcome would likely result in worker layoffs and product shortages. Businesses that decide to self-insure against future attacks, could also experience difficulties in attracting new capital and -- in the event of another assault -- would have to cover their own losses. That outcome would surely bankrupt some companies and further destabilize our economy.

A lack of terrorism reinsurance will also cause substantial burdens for the real estate sector, which accounts for about a quarter of our gross domestic product. In order to obtain a loan, banks usually require businesses to insure any property they pledge as collateral. But in this uncertain environment, some developers and building owners may find it impossible to obtain the coverage that lenders demand. Furthermore, without terrorist insurance, it could become prohibitively expensive, if not impossible, to build and operate in high-risk areas.

As a result, I believe that we must temporarily intervene in the reinsurance marketplace to safeguard against a cascading financial crisis. In recent weeks, several alternatives to solve this problem have emerged. One plan would establish a government backstop for a reinsurance pool designed to spread risk across the industry. Another approach using quotas would distribute reinsurance costs for terrorist acts between industry and the government. Other solutions include allowing insurance companies to build tax-free reserves, limiting liabilities for damages as we presently do for accidents at nuclear reactors, and facilitating the issuance of catastrophic bonds.

From my perspective, any legislation to assist the insurance industry and our economy in the short term should adhere to four principles:

- First, to the extent possible, the primary insurers must continue to bear a tangible share of the risk for future attacks through the use of deductibles, premiums, or assessments. Equity owners must also carry some share of the risk in order to encourage them to implement appropriate safety precautions.
- Second, we must sunset the program. The reinsurance industry is dynamic and we should not disrupt the development of new products.
- Third, in order to protect taxpayers we should consider placing caps on the government's liability and implementing adequate oversight.
- And fourth, everyone -- from the real estate mogul to the average homeowner -- should participate in the program.

As I said at our last hearing, we must move cautiously and methodically in addressing this problem in order to prevent unintended consequences. Given our forthcoming adjournment, however, we must also move forward expeditiously. Instead of convening additional hearings on this problem, we should quickly assemble a bipartisan and bicameral group to negotiate a solution with experts and industry leaders. Time is of the essence, and I stand ready to work with you, Mr. Chairman, and all other interested parties on these matters in the upcoming weeks.

In closing, I am looking forward to hearing from each of our witnesses today and especially from Professor David Cummins. Professor Cummins with the Wharton School of Business in Pennsylvania is an expert on insurance and risk management issues, and in recent weeks I have found his advice informative and insightful.